SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 947

FRANK WHITE, ET UX, MRS. FRANK WHITE,
Petitioners and Appellants Below,

vs.

W. A. THOMAS, COLLECTOR OF INTERNAL REVENUE.
Respondent and Appellee Below.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

Opinions of Courts Below.

The opinion in the District Court of the United States for the Northern District of Texas, Dallas Division, appears in the Record herein at page 127. It has not been officially reported. It was written by Hon. William H. Atwell, District Judge.

The opinion in the United States Circuit Court of Appeals for the Fifth Circuit appears in the Record herein at page 138. It is officially reported in 116 F. (2) 147. It was written by Hon. Samuel H. Sibley, Circuit Judge.

II.

Jurisdiction.

The basis for jurisdiction is set forth at page 4 of the foregoing petition.

III.

Statement of the Case.

This has already been stated in the preceding petition under Paragraph I, at page 1, which is hereby adopted and made a part of this brief.

IV.

Specification of Errors.

1. Both courts below erred in holding that the $125,000.00 received by Frank White was income to him within the meaning of the Sixteenth Amendment to the Constitution of the United States.

2. The District Court erred in holding that the $125,000.00 received by Frank White was not "the value of property acquired by gift" within the meaning of Section 22 (b) (3) of the Revenue Act of 1932.

3. The Circuit Court of Appeals erred in holding that the $125,000.00 received by Frank White was a "gain from the conversion of a gift", and hence taxable as income.

V.

Constitution, Statutes and Commissioner's Regulations Involved.

The Sixteenth Amendment to the Constitution of the United States. The Congress shall have power to lay and

collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

THE REVENUE ACT OF 1932.

The Revenue Act of 1932, *Section* 22 (26 *U. S. C. A., Sec.* 22 (*a*)), *Gross Income.* (a) General Definition.—"Gross income" includes gains, profits and income derived from salaries, wages, or compensation for personal services, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * * * *

(3) *Gifts, Bequests and Devises.—The value of property acquired by gift, bequest, devise or inheritance* (but the income from such property shall be included in gross income).

Commissioners Regulations 77.

Commissioners Regulation 77 *to the Revenue Act of* 1932. *Article* 51—*What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, un-

less exempt from tax by law. *In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.* • • •

Article 81.—*Exclusions from Gross Income.*—The term "gross income" as used in the Act does not include those items of income exempt by statute or by fundamental law.

Article 83.—*Gifts and Bequests.*—Property received as a gift, or received under a will or under statutes of descent and distribution is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. • • •

VI.

ARGUMENT.

Summary of Argument.

First Point. A conflict exists between several the Circuit Courts of Appeals on the question as to whether amounts received in compromise and settlement of claims of a non-taxable character are income subject to income tax.

(1) The United States Circuit Courts of Appeals for the Third, Fourth, and Sixth Circuits have held such amounts do not constitute income, because they are not gains derived from capital, from labor, or from both combined.

(2) The United States Circuit Court of Appeals for the Second Circuit, and the United States Circuit Court of Appeals for the Fifth Circuit (in the instant case) have held such amounts to be taxable income, on the theory that the claimant has "sold" or "converted" his claim,

which has no cost basis, into money or property, and thereby has "realized" income.

Argument on First Point.

(1)

In *Eisner* v. *Macomber,* 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, this Court held that in order to be "income"; within the meaning of the Sixteenth Amendment, an amount must be a gain derived from capital, from labor, or from both combined, including a gain derived from the sale or conversion of a capital asset, and that Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution. This definition has been adopted by the Commissioner of Internal Revenue in his Regulations. (See Commissioners Regulations 77 to the Revenue Act of 1932, quoted herein at Page 9.)

The United States Circuit Court of Appeals for the Third Circuit, in *Central Railroad Co.* v. *Commissioner of Internal Revenue,* 79 F. (2d) 697, held that an amount received in compromise and settlement of a suit for damages for fraudulent conspiracy was not income to the taxpayer, because the property received by him could not be traced to either capital or labor.

The United States Circuit Court of Appeals for the Sixth Circuit, in *Farmers & Merchants Bank* v. *Commissioner of Internal Revenue,* 59 F. (2d) 913, held that money received in compromise and satisfaction of a suit for damage and loss of business occasioned by malicious conduct on the part of the defendant, was not income to the taxpayer, because, considered in the light of the claim from which it was realized, there was no "gain", but only recompense for an injury.

The United States Circuit Court of Appeals for the Fourth Circuit, in *Magruder* v. *Segebade,* 94 F. (2d) 177,

held that money received by the taxpayer in consideration that he give up his claim to portions of a deceased's estate was not subject to income tax, because there was no gain derived from either capital or labor or from a sale or conversion of capital assets. This case is considered particularly important by petitioner because the conflict between it and the case of *Lyeth* v. *Hoey*, 96 F. (2d) 141, by the Circuit Court of Appeals for the Second Circuit, moved this Court to grant certiorari in *Lyeth* v. *Hoey*, resulting in the reversal of the *Lyeth* case. (See 305 U. S. 188, 59 S. Ct. 155.) The holding in *Lyeth* v. *Hoey* is discussed below.

(2)

The United States Circuit Court of Appeals for the Second Circuit has twice held that an amount received in compromise of a claim was income, on the theory that the claimant "sold" his claim and realized a taxable profit. In *Sterling* v. *Commissioner of Internal Revenue*, 93 F. (2d) 304, the court held that an amount received by a taxpayer in settlement of her claim to an interest in realty belonging to the estate of her deceased father was taxable in full, upon the theory, as stated in the court's opinion (at page 306) that "her claim to an interest in the premises would seem to have been a capital asset, the sale of which for a sum greater than it was worth on March 31, 1913, involved a taxable gain." Certiorari was denied by the Supreme Court. (303 U. S. 663, 82 L. Ed. 1121, 58 S. Ct. 829.)

Again, in *Monroe L. Lyeth* v. *Hoey, Collector*, 96 F. (2d) 141, the same court held that an amount received by an heir in compromise of litigation over a will was taxable in full, upon the ground that the taxpayer had certain rights in the deceased's estate, such rights costing him nothing, which he relinquished in return for the amount agreed upon, thus realizing a profit out of a "bargaining position". From the holding in this case, this court granted certiorari be-

cause of the conflict with the holding of the Fourth Circuit Court in *Magruder* v. *Segebade,* 94 F. (2d) 177, above mentioned. This court then reversed the Circuit Court for the Second Circuit, near the close of its opinion expressly disapproving the fallacious "bargaining position" theory, and affirmed the summary judgment of the District Court (20 F. Supp. 619) which had held the receipts not to be income because they were not a gain derived from capital, labor, or both combined.

Second Point. The United States Circuit Court of Appeals for the Fifth Circuit in the instant case has decided a Federal question in probable conflict with an applicable decision of this court.

(1) The decision of the Circuit Court of Appeals in the instant case is in probable conflict with an applicable decision of this Court, namely: *Lyeth* v. *Hoey,* 305 U. S. 188, 59 S. Ct. 155, 83 L. Ed. 119, 119 A. L. R. 410.

Argument on Second Point.

In *Lyeth* v. *Hoey* this Court held that property received by an heir in compromise and settlement of his claims in a will contest was acquired by inheritance, hence was exempt from income tax under the provisions of Section 22 (b) (3) of the Revenue Act of 1932 (47 Stat. at L. 178, chap. 209) which excludes from gross income "the value of property acquired by gift, bequest, devise or *inheritance.*" In reaching this conclusion this Court held:

(a) If the taxpayer's contest of the will had been fought to a successful finish, or if he had sued as heir for a portion of the estate and had recovered a judgment for such portion, what he received would have been acquired by inheritance, hence not taxable.

(b) The fact that the property was received under a compromise agreement in lieu of such a judgment did not change the character of what was received so as to render it taxable.

(c) The court expressly disapproved the theory upon which the court below found the receipt to be taxable income; namely, that taxpayer realized on a "bargaining position".

Notwithstanding this Court's expressed disapproval of the theory that one who received a consideration in compromise of a non-taxable claim realizes on a "bargaining position" taxable income, the United States Circuit Court of Appeals has decided the instant case upon this theory. We take the liberty of quoting that portion of the lower court's opinion so holding. (Found herein at R. page 140.)

"They (the executors and trustees of the Shannon Estate) paid him money for the release of the right which he claimed in the land. White sold that right, and conveyed it by suffering the adverse judgments. He converted it into cash; and the gain from the conversion of a gift is taxable, though the receipt of the gift originally was not. * * * He sold only his claim to recover it, which was in the nature of an incumbrance on the title, at a price which was only a fraction of the value of the land; and that claim he does not say cost him anything. What he received is income."

Respondent has heretofore contended that *Lyeth* v. *Hoey* was not applicable as an authority in the instant case, Frank White being no heir, and the litigation compromised not a will contest. But the Revenue Act of 1932 exempts both acquisitions by *inheritance* and acquisitions by *gift*. It applies to one claiming as a *donee* as well as to one claiming as an heir. The same principles of law, as enunciated by this Court, apply to both cases. Thus, had Frank White recovered the property claimed by him in his suit, it cannot

be doubted that such property would have stood as a gift. Does the fact that he accepted the amount involved in lieu of such property change its character for tax purposes? The slight difference in the facts of the two cases in no way affects the identical principles of law involved in both cases. The conflict arises, not out of the facts involved, but out of the application by the court below of an incorrect theory of law heretofore disapproved by this Court.

Conclusion.

From a consideration of the foregoing matters, it appears, first, that the decision in the instant case is in conflict with the decisions of other Circuit Courts of Appeal, which conflict should be resolved by the United States Supreme Court; second, that in the instant case a Federal question has been decided in conflict with an applicable decision of the Supreme Court;

WHEREFORE, petitioners respectfully submit that the writ of certiorari prayed for should be granted.

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